

Internal Revenue Service

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RE:

Legend

Settlor
Trust 1
Trust 2
Taxpayer
Date 1
Date 2
Date 3
Date 4
Date 5
Year
Child 1
Child 2
Child 3
Child 4
Child 5

Dear :

This letter responds to the letter from your authorized representatives dated June 19, 2010, and subsequent correspondence, requesting rulings concerning the generation-skipping transfer (GST) tax treatment with respect to Trust 1 and Trust 2.

The facts and representations submitted are summarized as follows:

On Date 1, Settlor executed Trust 1. On Date 2, Settlor executed Trust 2.

Both trusts provide that upon the death of Settlor, the net income of each trust is to be distributed annually, in equal shares, to Settlor's five children, Child 1 through

Child 5. Upon the death of a child of Settlor, the net income to be distributed to such child is to be distributed to such child's children, *per stirpes*. No principal may be distributed from a trust until the trust is terminates.

Trust 1 is to terminate upon the later occurrence of (1) the real property held within the trust has been developed as determined in the sole discretion of the trustee, or (2) upon the death of the last surviving child of Settlor. Trust 2 is to terminate upon the death of the last surviving child of Settlor. Upon termination, the undistributed net income and the principal of each trust is to be distributed *per stirpes* to the children of each of Settlor's children.

Settlor died on Date 3, which is before December 23, 1992. Child 1, one of Settlor's children, died five days later on Date 4. Settlor's executor did not allocate GST exemption to either trust.

Starting in Year, the trustees of Trust 1 and Trust 2 made distributions of net income each year to the children of Settlor. Child 1's one-fifth share of income was divided, *per stirpes*, among Child 1's living children. Taxpayer is one of Child 1's children.

On Date 5, Child 2 died. After Date 5, Child 2's one-fifth share of income was divided, *per stirpes*, among Child 2's living children.

You have requested the following rulings:

1. Proposed and Final Regulations issued after Settlor's death can reasonably be relied upon by Taxpayer as interpretations of Internal Revenue Code sections in effect at Settlor's death where there were no Proposed or Final Regulations applicable at the time of Settlor's death.
2. As a result of Settlor's death, the separate share rule of § 2654(b) of the Internal Revenue Code applies to the interest of each of Settlor's children.
3. As there were no regulations in effect in 1992 interpreting § 2612(c)(2) (1988), the 90-day rule under § 26.2651-1(a)(2)(iii) of the Generation-Skipping Transfer Tax Regulations is a reasonable interpretation of § 2612(c)(2). Therefore, because Child 1 died five days after Settlor, Child 1 is deemed to have predeceased the Settlor and Taxpayer qualifies to be stepped-up to Child 1's generational level.
4. In the alternative, if the Internal Revenue Service (Service) rules that the 90-day rule under § 26.2651-1(a)(2)(iii) does not apply, a qualified disclaimer under § 2518 executed by the estate of Child 1 would cause Child 1's separate share to be treated as if he had predeceased Settlor.

thereby making the transfer of the interest to Child 1's children a direct skip as defined in § 2612(c)(1). Thus, the children of Child 1 would qualify to be stepped-up to Child 1's generational level.

5. Child 1's death caused a partial taxable termination of the trust under § 2612(a)(2) for which the trustee was liable for the tax out of Child 1's share of the trusts. All distributions of net income to Taxpayer and the other children of Child 1 after the generation-skipping transfer (GST) tax is paid on the partial taxable termination as the result of Child 1's death would not constitute taxable distributions under § 2612(b).

LAW AND ANALYSIS

Rulings 2 and 5

Section 2601 imposes a tax on every generation-skipping transfer. A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2603(a) provides, in relevant part, that in the case of a taxable distribution, the tax imposed by § 2601 shall be paid by the transferee, and in the case of a taxable termination, the tax imposed by § 2601 shall be paid by the trustee. Section 2603(b) provides that, unless otherwise directed pursuant to the governing instrument by specific reference to the GST tax, the tax imposed on a GST shall be charged to the property constituting the transfer.

Section 2611(b)(2) provides that the term "generation-skipping transfer" does not include any transfer to the extent (A) the property transferred was subject to a prior tax imposed under this chapter, (B) the transferee in the prior transfer was assigned to the same generation as (or a lower generation than) the generation assignment of the transferee of this transfer, and (C) such transfer does not have the effect of avoiding tax under this chapter with respect to any transfer.

Section 2612(a) provides that a taxable termination means a termination by death, lapse of time, release of a power, or otherwise of an interest in property held in a trust where the property passes to a skip person. Section 2612(b) provides that a taxable distribution means any distribution from a trust to a skip person other than a taxable termination or a direct skip. Section 2612(c) provides that a direct skip means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613 defines the term "skip person" as (1) a natural person who is assigned to a generation that is two or more generations below that of the transferor, or (2) a trust in which either (a) all interests are held by skip persons or (b) there is no

person holding an interest in the trust and at no time after the transfer may a distribution (including distributions upon termination) be made from the trust to a non-skip person.

Section 2651(a) provides that, for purposes of the GST tax, the generation to which any person (other than the transferor) belongs shall be determined in accordance with the rules set forth in this section. Section 2651(b)(1) provides that an individual who is a lineal descendant of a grandparent of the transferor shall be assigned to that generation which results from comparing the number of generations between the grandparent and the individual with the number of generations between the grandparent and the transferor.

Section 2652(a) defines the term "transferor" for GST tax purposes. In general, the transferor is the last person with respect to whom the property was subject to an estate or gift tax.

Section 2654(b) provides that, for purposes of the GST tax, (1) the portions of a trust attributable to transfers from different transferors shall be treated as separate trusts, and (2) substantially separate and independent shares of different beneficiaries in a trust shall be treated as separate trusts. Except as provided in the preceding sentence, nothing in chapter 13 is to be construed as authorizing a single trust to be treated as two or more trusts.

Section 26.2654-1(a)(1) of the Generation-Skipping Transfer Tax Regulations provides that if a single trust consists solely of substantially separate and independent shares for different beneficiaries, the share attributable to each beneficiary (or group of beneficiaries) is treated as a separate trust for purposes of chapter 13. The phrase "substantially separate and independent shares" generally has the same meaning as provided in § 1.663(c)-3 of the Income Tax Regulations. However, a portion of a trust is not a separate share unless such share exists from and at all times after the creation of the trust. Additions to and distributions from such trusts are allocated pro rata among the separate trusts, unless the governing instrument expressly provides otherwise.

Section 1.663(c)-3(a) generally provides that shares of a trust shall be considered to be separate shares if distributions from the trust are to be made in substantially the same manner as if separate trusts had been created. Separate shares will exist where an instrument directs the trustee to divide the testator's residuary estate into separate shares (which under applicable law do not constitute separate trusts) for each of the testator's children and the trustee is given discretion, with respect to each share, to distribute or accumulate income or to distribute principal or accumulated income, or to do both.

Section 1.663(c)-3(b) provides that separate share treatment will not be applied to a trust subject to a power to: (1) distribute, apportion, or accumulate income, or (2) distribute corpus to or for one or more beneficiaries within a group or class of

beneficiaries, unless payment of income, accumulated income, or corpus of a share of one beneficiary cannot affect the proportionate share of income, accumulated income, or corpus of the other beneficiaries. Section 1.663(c)-3(c) provides that a share may be considered separate even though more than one beneficiary has an interest in it. For example, two beneficiaries may have equal, disproportionate, or indeterminate interests in one share which is separate and independent from another share in which one or more beneficiaries have an interest.

Section 26.2654-1(a)(5), Example 1, illustrates a situation where T transfers \$100,000 to a trust under which income is to be paid in equal shares for 10 years to T's child, C, and T's grandchild, GC (or their respective estates). The trust does not permit distributions of principal during the term of the trust. At the end of the 10-year term, the trust principal is to be distributed to C and GC in equal shares. The shares of C and GC in the trust are separate and independent and, therefore, are treated as separate trusts. The result would not be the same if the trust permitted distributions of principal unless the distributions could only be made from a one-half separate share of the initial trust principal and the distributee's future rights with respect to the trust are correspondingly reduced. T may allocate part of T's GST exemption under § 2632(a) to the share held for the benefit of GC.

In this case, according to the terms of Trust 1 and Trust 2, upon the death of a child of Settlor, such deceased child's one-fifth share of the net income of Trust 1 and Trust 2 is to be distributed to the children of the deceased child, *per stirpes*. In addition, these children of the deceased child are entitled to share, collectively, in one fifth of the trust principal upon the death of the last of Settlor's children. Thus, we conclude that each of Trust 1 and Trust 2 is comprised of five substantially separate and independent shares for purposes of § 2654(b).

Because Trust 1 and Trust 2 are each comprised of five substantially separate and independent shares, upon the death of Child 1, Child 1's separate share vests completely in the children of Child 1. Based upon the facts submitted and representations made, we conclude that because the children of Child 1 are skip persons and no non-skip persons continue to be beneficiaries of that separate share, a taxable termination over that separate share occurs. Further, we conclude that GST taxes will be paid by the trustee of each trust from Child 1's one-fifth share of the trust, and all future distributions from each trust to the children of Child 1 will not be subject to GST tax.

Ruling 3

Section 2612(c)(2), as in effect on Date 3, provided a special rule pertaining to the determination of whether any transfer was a direct skip. Specifically, § 2612(c)(2) provided, in relevant part, that for purposes of determining whether any transfer is a direct skip, if (A) an individual is a grandchild of the transferor (or the transferor's spouse

or former spouse), and (B) as of the time of the transfer, the parent of such individual who is a lineal descendant of the transferor (or the transferor's spouse or former spouse) is dead, such individual shall be treated as if such individual were a child of the transferor and all of that grandchild's children shall be treated as if they were grandchildren of the transferor. If any transfer of property to a trust would be a direct skip but for this paragraph, any generation assignment under this paragraph shall apply also for purposes of applying this chapter to transfers from the portion of the trust attributable to such property. Paragraph (c)(2) was stricken from the Code by the Taxpayer Relief Act of 1997, P.L. 105-34 (111 Stat. 788).

Section 2651 sets forth rules to determine the generation to which any person (other than the transferor) belongs.

Section 2651(b) provides that an individual who is a lineal descendant of a grandparent of the transferor shall be assigned to that generation which results from comparing the number of generations between the grandparent and such individual with the number of generations between the grandparent and the transferor.

Section 2651(e)(1), as added by the Taxpayer Relief Act of 1997, effective for terminations, distributions, and transfers occurring after December 31, 1997, provides a special rule for determining the generation assignment of individuals with a deceased parent. For purposes of determining whether any transfer is a generation-skipping transfer, if (A) an individual is a descendant of a parent of the transferor (or the transferor's spouse or former spouse), and (B) such individual's parent who is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse) is dead at the time of the transfer (from which an interest of such individual is established or derived) is subject to the estate tax or the gift tax upon the transferor, such individual shall be treated as if such individual were a member of the generation which is one generation below the lower of the transferor's generation or the generation assignment of the youngest living ancestor of such individual who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse), and the generation assignment of any descendant of such individual shall be adjusted accordingly.

Section 26.2651-1(a)(1) provides that § 26.2651-1(a) applies for purposes of determining whether a transfer to or for the benefit of an individual who is a descendant of a parent of the transferor (or the transferor's spouse or former spouse) is a GST. If that individual's parent, who is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse), is deceased at the time the transfer (from which an interest of such individual is established or derived) is subject to the tax imposed on the transferor by chapter 11 or 12, the individual is treated as if that individual were a member of the generation that is one generation below the lower of (i) the transferor's generation; or (ii) the generation assignment of the individual's youngest living lineal

ancestor who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse).

On July 15, 2005, the Service published final regulations at T.D. 9214 which added § 26.2651-1(a)(2)(iii) to the regulations. Section 26.2651-1(a)(2)(iii) currently provides that for purposes of § 26.2651-1(a)(1), any individual who dies no later than 90 days after a transfer occurring by reason of the death of the transferor is treated as having predeceased the transferor. This provision is known as the 90-day rule.

On December 26, 1995, the Service published final regulations at T.D. 8644 which included an earlier version of the 90-day rule. Section 26.2612-1(a)(2)(i), as in effect after December 26, 1995, provided that solely for the purpose of determining whether a transfer to or for the benefit of a lineal descendant of the transferor, the transferor's spouse, or a former spouse of the transferor is a direct skip, the generation assignment of the descendant is determined by disregarding the generation of a predeceased individual who was both an ancestor of the descendant and a lineal descendant of the transferor, the transferor's spouse, or a former spouse of the transferor (a predeceased child). If a transfer to a trust would be a direct skip but for this paragraph, any generation assignment determined under this paragraph continues to apply in determining whether any subsequent distribution from (or termination of an interest in) the portion of the trust attributable to that transfer is a GST. A living descendant who dies no later than 90 days after the subject transfer is treated as having predeceased the transferor to the extent that either the governing instrument or applicable local law provides that such individual shall be treated as predeceasing the transferor. Except as provided in this paragraph (a)(2), a living descendant is not treated as a predeceased child solely by reason of applicable local law; e.g., an individual is not treated as a predeceased child solely because state law treats an individual executing a disclaimer as having predeceased the transferor of the disclaimed property.

Section 26.2601-1(c) provides, in relevant part, that the regulations under § 26.2612-1 are effective with respect to generation-skipping transfers made on or after December 27, 1995. However, taxpayers may, at their option, rely on these regulations in the case of generation-skipping transfers made, and trusts that became irrevocable, after December 23, 1992 and before December 27, 1995.

In this case, Settlor died on Date 3, a date before December 23, 1992. Because there was no immediate right to income or principal vested in any skip persons, no direct skip, as defined in § 2612(c)(1), occurred upon the death of Settlor. Because the 90-day rule under § 26.2612-1(a)(2)(i) only applies if the transfer is a direct skip, the 90-day rule under § 26.2612-1(a)(2)(i) does not apply here. Moreover, neither the rule under § 26.2651-1(a)(2)(iii) nor the rule under § 26.2612-1(a)(2)(i) were in effect as of Date 3. Therefore, based upon the facts submitted and representations made, we

conclude that the children of Child 1 do not qualify to be stepped-up to Child 1's generational level pursuant to the special rules contained in § 26.2651-1(a)(2)(iii).

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Except as expressly provided herein, we express no opinion on the federal tax consequences of the transactions under the cited provisions or under any other provisions of the Code. Pursuant to section 3.02(8) of Rev. Proc. 2010-3, 2010-1 I.R.B. 110, 115, the Service may decline to address questions that the Service determines, in its discretion, should not be answered in the general interests of tax administration. Accordingly, we decline to rule on Rulings 1 and 4.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Associate Chief Counsel
Passthroughs & Special Industries

By: Leslie H. Finlow, Senior Technician Reviewer
Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

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cc: